

- (NPA), increasing appellants' taxable income by the excluded wages, and proposing additional tax of \$3,662, plus interest.
3. Appellants protested the NPA, asserting that the subtracted wage income was family leave compensation, and that they followed TurboTax instructions when completing the tax return. In support, appellants provided FTB with Forms W-2 for R. Medrud and E. Medrud.
 4. FTB reviewed the documentation and determined that appellants did not establish error in the proposed assessment.
 5. FTB issued a Notice of Action affirming the NPA. This timely appeal followed.

DISCUSSION

The law requires FTB to examine returns and determine the correct amount of tax due. (R&TC, § 19032.) When FTB determines that the tax disclosed in the original return is less than the tax disclosed by its examination, it must propose a deficiency assessment. (R&TC, § 19033.) FTB's determination is presumed correct, and taxpayers have the burden of establishing that they are entitled to exclude disability income, including Paid Family Leave (PFL). (*Appeal of Jindal*, 2019-OTA-372P.) To carry that burden, taxpayers must point to an applicable statute and show by credible evidence that they come within its terms. (*Ibid.*)

California residents are subject to tax on their entire taxable income, regardless of where that income is earned or sourced. (R&TC, § 17041(a).) R&TC section 17071 generally incorporates by reference Internal Revenue Code (IRC) section 61, which defines "gross income" to include compensation for services, including fringe benefits and similar items. (IRC, § 61(a)(1).) Thus, California taxes residents on their employment income, including supplemental pay, such as vacation and sick pay, regardless of source.

Exceptions to the taxation of employment-related income include PFL, which is administered and paid by the Employment Development Department (EDD).³ (See *Unemp. Ins.*

³ For example, under California's Unemployment Insurance Code, PFL is a temporary disability insurance program that provides partial wage replacement benefits under specified circumstances. (See *Unemp. Ins. Code*, §§ 2625 et seq., 3300 et seq.) For the 2018 tax year, PLF provided up to six weeks of wage replacement benefits in a 12-month period for individuals to care for a seriously ill family member or bond with a new child. (*Unemp. Ins. Code*, § 3301(a)(1), (d).)

Code (UIC), §§ 2601, 3301.)⁴ PFL is a component of the state’s unemployment compensation disability insurance program and is administered in accordance with the policies of the state disability insurance (SDI) program. (UIC, § 3300(g).) As such, PFL benefits are treated as unemployment compensation paid pursuant to a governmental program and are excluded from gross income for California purposes. (R&TC, § 17083.)⁵ EDD will issue a Form 1099-G reporting benefits EDD paid which are excluded from gross income for California purposes, such as PFL benefits.

In addition, California law also allows an employer to use an approved voluntary program (VP), a private short-term disability insurance plan, for the payment of disability benefits in lieu of participating in the SDI coverage (e.g., PFL) provided by EDD. (See UIC, §§ 3251, 3253.) The VP must be approved by EDD and is subject to termination by EDD. (UIC, §§ 3254, 3262.) To exclude VP payments of PFL from gross income, taxpayers must show that the payments are unemployment compensation paid pursuant to a governmental program. (R&TC, § 17083; IRC, § 85; Treas. Reg. § 1.85-1(b)(1)(i).)

With respect to third-party sick pay, amounts received by an employee through accident or health insurance for personal injuries or sickness must be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer. (R&TC, § 17131; IRC, § 105(a).) An exception exists for amounts received through accident or health insurance for personal injuries or sickness that are not attributable to contributions paid by an employer and these amounts may be excluded from gross income. (IRC, § 104(a)(3).) Therefore, if an individual uses his or her own funds to purchase a policy covering personal injuries or sickness, amounts received are excludable from gross income. (Treas. Reg. § 1.104-1(d).)

Here, appellants subtracted \$114,254 of wage income from their 2018 California gross income. Appellants contend the amount was properly excluded as PFL compensation appellants

⁴ References to the Unemployment Insurance Code refer to the version applicable for the 2018 tax year.

⁵ IRC section 85 provides that certain unemployment compensation is taxable at the federal level. According to Treasury Regulation section 1.85-1(b)(1)(i), the compensation contemplated by IRC section 85 is “unemployment compensation paid pursuant to governmental programs and does not apply to amounts paid pursuant to private nongovernmental unemployment compensation plans (which are includible in income without regard to [IRC] section 85).” California law specifically does not follow IRC section 85, and therefore excludes from taxation unemployment compensation that is paid pursuant to a governmental program. (R&TC, § 17083.)

received in 2018. However, appellant’s assertion that the income is nontaxable PFL benefit payments is not supported by the evidence. While appellants provide Forms W-2 for R. Medrud and E. Medrud, the forms do not indicate that the wage income is excludable from gross income for California purposes. Appellants have provided no evidence indicating that they received PLF benefits paid by EDD (such as a Form 1099-G), that the payments are from an approved VP (such as a Form W-2 from the insurance company and documentation showing the VP is regulated by the EDD), or that the payments were nontaxable third-party sick pay (such as documentation indicating appellants used their own funds to purchase the policy). OTA finds that appellants have not shown that the \$114,254 at issue is attributable to nontaxable benefit payments such as disability insurance benefit payments (see UIC, § 2601), PFL benefit payments (see UIC, § 3301), or other nontaxable benefit payments, and therefore appellants have not shown that they are entitled to subtract \$114,254 of wage income from their 2018 California gross income.

HOLDING

Appellants have not established that they are entitled to a subtraction of \$114,254 from their 2018 California gross income.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

We concur:
DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Andrea Lt Long
272945E7B372445...

Andrea L.H. Long
Administrative Law Judge

Date Issued: 10/26/2023